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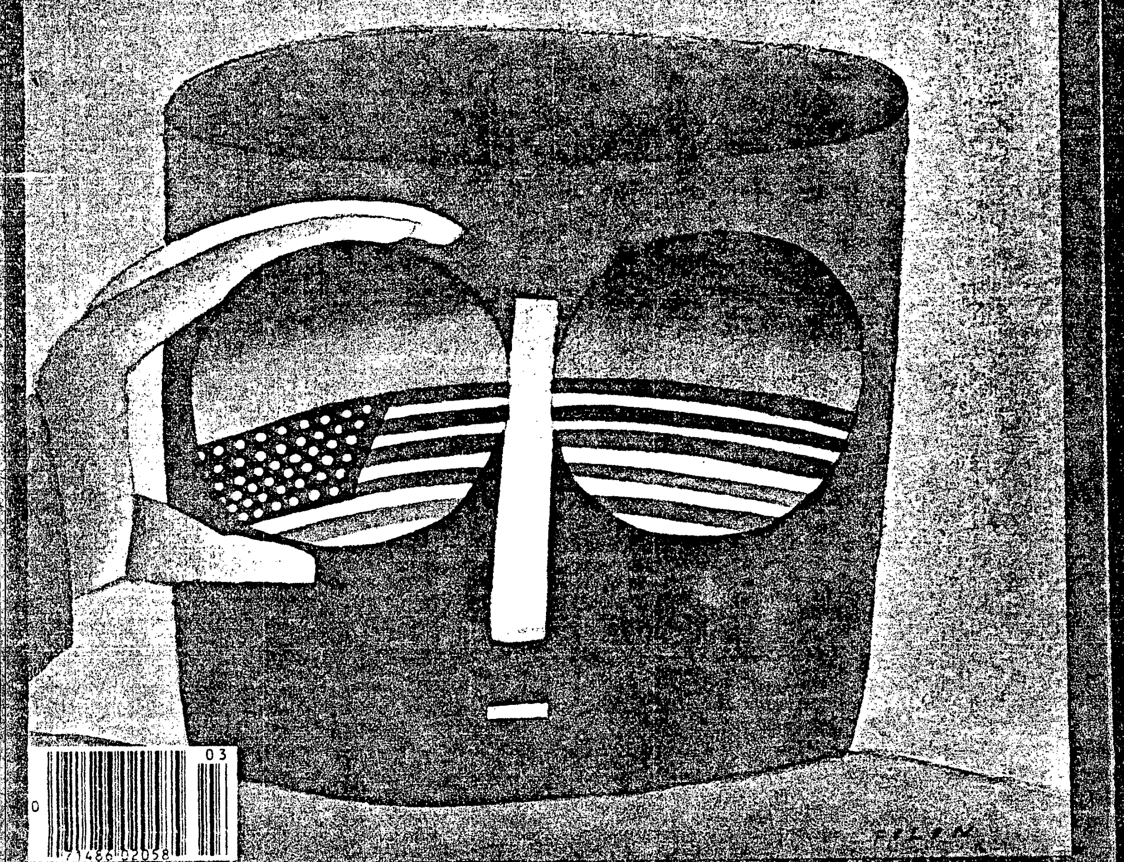
EDWARD JAY EPSTEIN ON THE OPEC ILLUSION / JAMES FALLOWS ON NEW COMPUTER PROGRAMS

THE NEXT AMERICAN FRONTIER

What's Really Wrong With the American Economy

BY ROBERT B. REICH



Saudi Arabia finds in the perceived unity and power of OPEC a convenient illusion

THE CARTEL THAT NEVER WAS

BY EDWARD JAY EPSTEIN

OPEC, WHICH STANDS FOR THE ORGANIZATION OF PEtroleum Exporting Countries, is a four-letter word synonymous with prodigious wealth, arbitrary power, and fear. The wealth is from the combined oil sales of its thirteen member nations, which exceeded $240 billion in 1981—a sum greater than half of the entire M-1 money supply in the United States; the power from the fact that its members control nearly two thirds of the free world's oil reserves; and the fear from the threat that OPEC might cut off this lifeline of energy, paralyzing the world's economy. Sixteen industrial nations, led by the United States, banded together in 1974 to create an organization known as the International Energy Agency, which, in the event of a dreaded OPEC cutoff, would ration the remaining supply of oil among the industrialized nations. OPEC was taken so seriously that in 1979 President Jimmy Carter specifically blamed OPEC for both the recession and inflation, and there were even hints from Henry Kissinger of American military actions against OPEC. Indeed, no other organization, with the possible exception of the first Communist Internationale, has excited such fears on a global scale.

The continued preoccupation with the potential threat of OPEC, however, distracted attention from the actual flesh-and-blood organization that inspired it. Despite a booming voice that has reverberated through the world's media for the past decade, it turns out that OPEC is an astoundingly small organization. Its headquarters, in Vienna, is its only office: there are no branches or representatives elsewhere. Except for the alert squad of Austrian "Cobra" commandos with submachine guns guarding the entranceway, the four-story building at Donaustrasse 93 in downtown Vienna resembles any other modern office building in Europe. It is built of gray marble and glass, with a small parking lot in front, and almost identical buildings on either side, housing IBM and an Austrian bank. In 1982, twenty-two years after it was founded, OPEC employed only thirty-nine persons—all men—on its executive staff. Not counting a few dozen Austrian secretaries and clerks and a handful of employees of OPEC's Fund for International Development (which awards grants and other largesse to countries in the Third World), this staff of thirty-nine men constituted the entire worldwide employment of OPEC. It included everyone from the secretary general to the press officers.

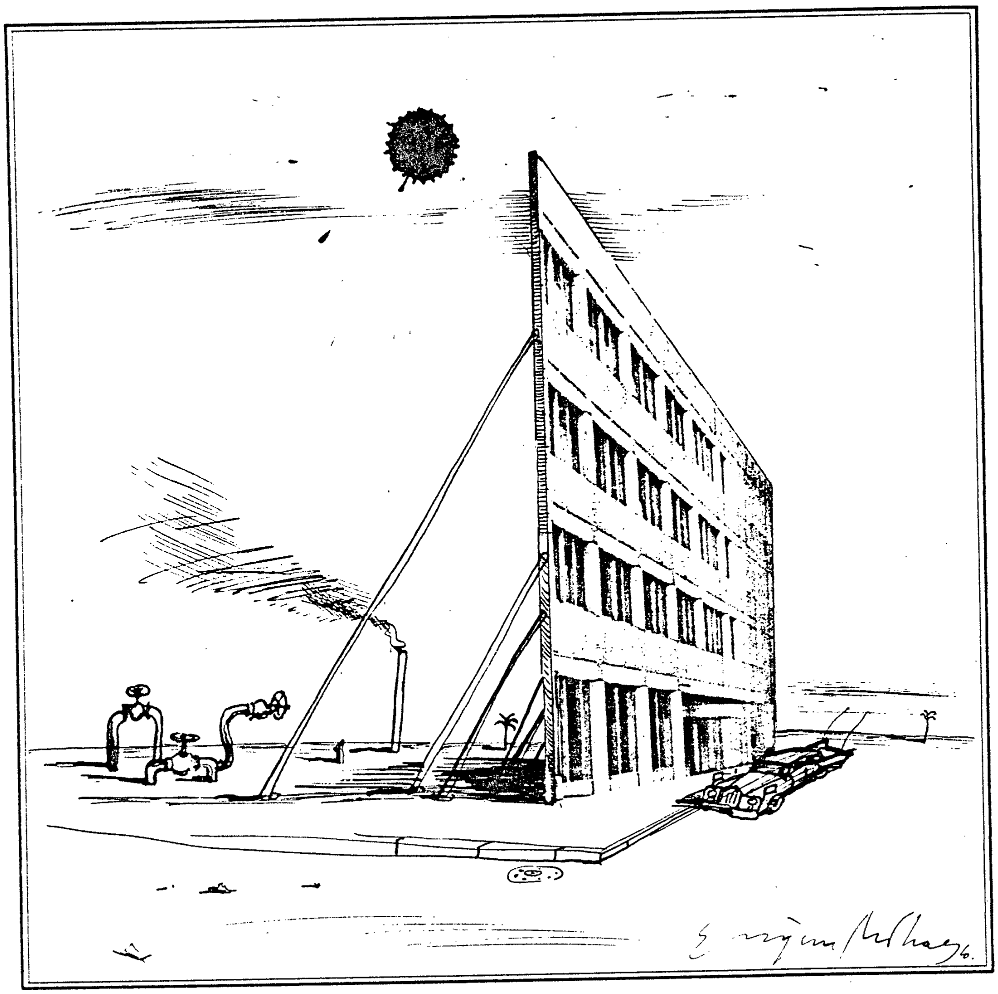
Last September, I was taken through the headquarters. The most prominent part of OPEC is the huge press auditorium on the ground floor, which is more than twice the size of its counterpart in the White House. It is surrounded by state-of-the-art communications facilities for the press, on which no expense has been spared: a fully equipped color-television studio for taping interviews with OPEC spokesmen, telephones and Telexes for reporters' use in dispatching stories, a multilith printing press for churning out press releases, and a library of energy publications. There is even an in-house wire service, called OPECNA, which feeds announcements and other news releases to subscribing newspapers and radio stations. Aside from these services to reporters, OPEC edits a number of glossy publications—including a monthly OPEC bulletin, the annual report, and illustrated briefing books.

Behind the auditorium, through a locked door, is the computer room, which contains the institutional memory of OPEC. The computer itself is a medium-size IBM 4341, installed in 1980 and programmed by a group of American consultants from the University of Southern California in Los Angeles. The air-conditioned room is crammed with metallic cabinets storing the hard disks of computer memory. In the center is a control console manned by a Viennese operator. When he initially attempted to demonstrate to me the computer's graphic abilities, the screen, after an embarrassingly long hesitation, came up blank. "This is of course not the top-of-the-line IBM," he said apologetically, re-entering the instructions on the keyboard. This time, the computer drew out a multicolored graph of prices for different grades of crude oil. The data was eight days old.

The operator explained that the computer has no direct telecommunication links to the oil markets and loading facilities. Instead, the data on prices comes by mail from *Platt's Oilgram Price Report*, an oil-industry newsletter published in Houston and New York. Each day, the prices published in *Platt's* have to be entered into the OPEC computer. Since there are only two programmers at OPEC, the information in the computer is often outdated.

When it came to displaying oil production from individual OPEC countries, the computer was out of date by

Edward Jay Epstein, author most recently of The Rise and Fall of Diamonds, *is at work on a book about international deception.*



months. "The problem is political," the operator explained: the OPEC countries refuse to provide the Vienna headquarters with data on how much oil they are producing and shipping. While some members, such as Indonesia, Venezuela, and Saudi Arabia, do furnish some data—after a delay of from two to six months—other members, such as Libya, Iran, and Nigeria, refuse to supply any figures at all on production and oil shipments. The result is that OPEC relies for much of its information about oil production on the International Energy Agency, in Paris—the organization created to combat OPEC—and the IEA, in turn, relies mainly on the data of the United States Department of Energy, which, to complete the circle, draws its data from the reporting of the major oil companies. The picture of the oil market whirled out in four colors by the OPEC computer is thus not the product of the daily reality of oil loadings in the Persian Gulf or other ports of OPEC countries but the product of outdated statistics from oil companies which have been filtered through government bureaucracies.

When we left the computer room, Dr. Edward Omotoso, a former journalist from Nigeria who is now OPEC's head of communications, wistfully acknowledged that the data base was "not perfect." He explained, "OPEC is not the CIA. We do not have satellites in the skies to count every oil tanker. We are not really that sort of an organization."

He added, "We are not even a wealthy organization."

The annual budget for OPEC, like the size of the staff, seems far more appropriate for a small business than for what the press has often called the "most powerful group on earth." In 1981, the allocated budget was about $13.4 million (not all of it spent), most of which went for the cost of publishing OPEC's bulletin, books, and annual report. Saudi Arabia's share, for example (equal to that of the other members), was $906,250 in 1981—equivalent to the revenue it earned in about four minutes from its oil fields. "We have to watch even the cost of our long-distance telephone calls," an Iranian finance officer in OPEC said, referring to the infrequent communications with the oil-producing centers.

"No one considers the OPEC assignment a plum," an OPEC executive explained. Although some employees see in OPEC a chance to escape authoritarian regimes and seek opportunities in the West, a job at OPEC is usually a detour from the path of advancement at a national oil company. And as it turns out, many OPEC technocrats do not return to jobs in their home countries; they frequently go on to be oil consultants in Geneva or Paris. A number of OPEC executives were openly dissatisfied with the chaotic and unpredictable working conditions. "There are a number of vacancies on the staff," Dr. Omotoso said, as he reviewed the roster.

The position of secretary general, which rotates among the thirteen member nations every two years, is currently held by Dr. Marc Nan Nguema, a Gabonese civil servant. Dr. Nguema spends a considerable part of his time representing OPEC at energy seminars, conferences, and other ceremonial occasions. His Office of the Secretary consists of an assistant and a speech writer. (In December, the OPEC ministers voted against extending the term of Dr. Nguema after he was severely criticized by Saudi Arabia, Kuwait, and the United Arab Emirates for exceeding his expense account and travel allowance.) The de facto head of OPEC is the deputy secretary general, Dr. Fadhil J. Al-Chalabi, a fifty-three-year-old Iraqi lawyer and former minister who before joining OPEC, in 1978, ran OAPEC, a completely different group composed entirely of Arab oil producers. Directly under Dr. Al-Chalabi is the Division of Research, headed by another Iraqi, which employs more than half the staff. Its job is to gather and analyze data about the international oil trade. The other major job of OPEC, also under Chalabi's control, is image-making. The products of its international PR machine, according to OPEC's last annual report, include the commissioning of a book on the history of OPEC, entitled *OPEC: An Instrument of Change*; films with titles such as *For the Benefit of All* and *Sweet and Sour* (two types of crude oil); subsidized OPEC Workshops for Journalists of the Third World, designed to "counteract misinterpretations and distortions in the media of OPEC's aims"; a commemorative OPEC postage stamp; and the daily release of "news" through the OPEC wire service. These activities aim at reversing the "virulent calumnies" and "brainwashing" of the media in the West.

Aside from research and public relations, the OPEC staff takes care of the more mundane housekeeping chores of the organization, including hotel and airplane reservations; security arrangements; payroll, bookkeeping, and the hiring and firing of local clerks and secretaries. None of these tasks involves any control of the oil market.

"OPEC is merely a service organization for thirteen sovereign oil-producing nations," explained Bahman Karbassioun, an Iranian who has been associated with OPEC for nearly ten years. "We provide background data, such as the amount of OPEC oil that can be sold at a given price, to the ministers when they meet," he added. "All decisions are up to them."

The thirteen oil ministers of the member nations meet at conferences that, according to the OPEC charter, "are the supreme authority of the Organization." These conferences are convened semi-annually, and additionally whenever a majority of members requests an extraordinary session. (In OPEC's twenty-two-year history, it has held an average of about three conferences a year.) At these conferences, it is required that all decisions be made unanimously. Then decisions must be ratified by the thirteen governments before taking effect. No member, not even if it is in a minority of one, can be forced to abide by a decision to which it did not explicitly agree. There is, therefore, no need for a mechanism in OPEC for implementing, verifying, or even monitoring agreements. Compliance is completely voluntary. Most OPEC decisions concern the base price for crude oil. Members can easily evade such price decisions through the simple expedient of altering terms—such as quality or transportation differentials—thereby giving discounts or premiums.

Technically, it would be relatively easy for OPEC to enforce price decisions, by keeping track of the crude-oil sales: most oil is loaded onto tankers from only a dozen or so terminals. But members won't allow OPEC to measure the actual flow of oil from their terminals, for good reason: despite the appearance of unity, they are all competitors for shares of the world market. (Some members, such as Iran and Iraq, are not just rivals for power but actually at war.) Current oil sales are considered by many OPEC states to be the equivalent of state secrets. Saudi Arabia declared in 1980: "We refuse on principle to even discuss the subject of production, which concerns us alone. Our decisions on production derive from market conditions and Saudi Arabia's international commitments."

When the oil ministers meet at OPEC conferences, they therefore have no choice but to depend on their own national data. Moreover, some ministers are more equal than others. Sheikh Ahmed Zaki Yamani, the Harvard-trained oil-and-resource minister of Saudi Arabia, often plays the lead role at these conferences. "Yamani's in charge of long-term strategy," one Iranian technocrat explained, and added, "It is no coincidence that the benchmark price for

Saudi crude oil is the official OPEC price." From his perspective, Saudi Arabia attempts to use OPEC to force the twelve other producing countries to support its standard oil price.

OPEC, with its minuscule staff and tiny budget, clearly is not the sort of cartel that has captured the public's imagination. A cartel, by definition, has one indispensable characteristic: it must be able to restrict the supply of the commodity reaching the marketplace. Yet, although individual OPEC members can cut back on the amount of oil that they supply, OPEC itself is powerless to interfere in such decisions. As Sheikh Yamani said at the last OPEC meeting in Vienna, in December, "Production decisions are made in Riyadh, not Vienna." OPEC not only lacks power to impose its will on recalcitrant members, it lacks the basic information needed to operate a cartel. At best, it is only a shadow of the former international cartel of oil companies that previously controlled almost the entire oil trade. This group, known as "the Seven Sisters," was a real cartel, with thousands of employees and unlimited funds. It is useful to compare the operations of a real cartel with those of OPEC.

THE INTERNATIONAL OIL CARTEL TRACES BACK TO a grouse shoot at Achnacarry Castle, in Inverness, Scotland, in September of 1928, which was attended by the heads of the three most powerful oil combines in the world—Sir Henri Deterding, the chairman of Royal Dutch Shell; Walter Teagle, of Standard Oil of New Jersey (now Exxon); and Sir John Cadman, chairman of Anglo-Persian Oil (now BP). Under the pretext of engaging in sport, these three men conspired to eliminate competition in developing new oil resources for the world. The mechanism was the "as is" principle, under which all agreed to divide future markets among themselves according to the shares of the market they held in 1928. This meant that there would be no advantage in "destructive competition," as the companies put it, among themselves for new oil fields: whatever advantage one company received would be shared proportionally by the others. In a separate "pooling" accord, the three companies also agreed to share their oil tankers, refineries, pipelines, and marketing facilities with each other. As the membership of the cartel expanded to include the other major companies, it became known as the Seven Sisters. The cartel controlled oil production, refining, transportation, and sales in almost all areas of the world except the United States, which had strict antitrust laws.

The cartel's principal instrument of control was local consortiums set up to manage and develop oil fields in the Middle East, Venezuela, and wherever else oil was discovered. Each consortium was owned by members of the Seven Sisters in a ratio determined by the "as is" principle; each operated as an essentially nonprofit service entity, producing only enough oil to meet the requirements of its owners. To assure that supply never exceeded the demand for oil, the partners submitted "programs" specifying the oil they needed for five years, and the consortium set its exploration and development programs according to these requisites. If less oil was required by the oil companies, the consortiums would close down wells; or, if required by the country's law to drill for oil (as in Iraq), would drill in areas they knew would not yield any. The system proved so successful that by 1970 more than 90 percent of the world's exportable oil was being produced by consortiums in Iran, Iraq, Saudi Arabia, Kuwait, the United Arab Emirates, and almost every other oil-rich area.

From its refineries, tankers, and loading platforms, the Seven Sisters cartel had complete knowledge of all facets of the oil market. It also had the power to shut down entire nations that interfered with its concessions: when Mohammed Mossadegh, the prime minister of Iran, nationalized the country's oil industry, in 1951, the cartel denied Iran use of its refineries and tankers for two years, nearly bankrupting the country. Through its network of consortiums, the cartel had absolute control over how much oil was produced and shipped.

The strains that led to the breakup of the Seven Sisters cartel proceeded from a single issue: the division of profits between the international oil companies and the countries from whose territory the oil gushed. Until 1971, the cartel's consortiums gave the countries a set percentage—50 percent in most cases—of an arbitrary price, called the "posted price," that the oil companies paid for each barrel. If an independent oil company attempted to buy oil, it would have to pay a much higher, "third-party" price. It was, of course, in the interest of the oil cartel to keep its posted price as low as possible, and make its profits selling refined oil. In 1970, for example, the posted price was $1.80, as it had been, with minor fluctuations, for twenty years; consumers in Western Europe paid the equivalent of $11 to $13 a barrel for refined oil.

The delicate balance that the cartel had maintained in the world export market for a half-century was irreversibly upset in the late 1960s by the unexpected decline in oil production in the Western Hemisphere. The United States, which had been almost self-sufficient in oil, became a significant importer of Middle Eastern oil. As the scramble for the available supply intensified, it became evident that prices would be forced inexorably upward. With prices for gasoline, heating oil, jet fuel, and other refined products rising in Europe, the countries that produced oil—notably Saudi Arabia, Iraq, Iran, and Libya—were not content with their share of the fixed posted prices; instead, they demanded at least part of the coming windfall.

The first cracks in the cartel's control came in 1970 in Libya—the one major exporter that had granted concessions to independent companies outside the purview of the consortiums. Under the revolutionary leadership of Colonel Qaddafi, Libya threatened to nationalize the independent companies unless they increased Libya's share. Eventually, the largest independent producer, Occidental Petroleum, acquiesced to Qaddafi's demands. Then Saudi Arabia, Iraq, Iran, and other producers in the Persian Gulf demanded that the consortiums grant them the same terms Libya had obtained. When the cartel acceded to these demands, Libya put pressure again on the oil companies, and the cartel found itself caught in a ratchet between Libya and the Persian Gulf producers, both demanding more favorable terms. To solve this problem, the oil companies devised a strategy to force the oil-producing countries to negotiate as a single bloc. Because some of the principal producers were bitter rivals who refused to bargain together, the cartel sought a multinational organization under whose auspices they could assemble for negotiations with the oil companies. In January of 1971, the cartel chose a small Vienna-based group, with a staff of nine, whose very existence it had ignored for the past eleven years—OPEC. A letter signed by the oil companies in the cartel began: "We wish to place before OPEC and its member countries the following proposal. . . ."

OPEC had originally been established in Baghdad on September 10, 1960, as an intergovernmental group to study posted oil prices. Its five founding members were Saudi Arabia, Venezuela, Iran, Kuwait, and Iraq. During its first six years, which went virtually unnoticed in the press, OPEC based itself in Geneva and opened an "information office," which commissioned occasional studies on crude prices. It also admitted three new members—Qatar, Indonesia, and Libya. After its headquarters moved to Vienna (where the organization was offered diplomatic status for its staff), in 1966, OPEC's main activity became issuing proclamations declaring "solidarity" with the escalating demands of the more rebellious oil producers—notably Libya and Algeria, which joined in 1969. The proposal to serve as a negotiating umbrella for the oil-producing countries was accepted by OPEC, as Henry Kissinger notes in his memoirs, "with a vengeance."

In OPEC, the oil companies found not only a convenient device to bring together feuding states but also a highly visible foe they could blame for the impending rise in oil prices. To negotiate as a single force with this new monolith, the oil companies obtained an antitrust exemption for themselves from the Justice Department. It was not without some irony that OPEC was finally pressed into service by the cartel in Tehran in 1971—a service it had waited eleven years to perform.

Initially, the oil companies' OPEC strategy seemed successful. It produced the Tehran Agreement, in which the producing states, in return for a modest rise in the posted price to \$2.18 a barrel and some favorable revisions in the concession terms, accepted a five-year accord that would freeze oil prices. This OPEC agreement lasted only a few months. Each country, ignoring the agreement, insisted that it had sovereignty over its oil concession. The "five-year" Tehran Agreement disintegrated into a free-for-all, and, one by one, the consortiums were nationalized.

WHATEVER HOPES THE INTERNATIONAL OIL COMPANIES had of reasserting control over the oil-producing nations ended on Yom Kippur of 1973, with the Egyptian invasion of the Sinai. The renewed war in the Middle East caused an oil-buying frenzy in Europe and Japan, as nations fought to build up their reserves of crude oil. Saudi Arabia and other oil producers adopted a policy of charging whatever the freight would bear. Within weeks, the posted price for crude had more than doubled, to \$5.60 a barrel. No OPEC control was involved: it was a *force majeure* that permitted individual nations to raise their prices.

Another price explosion followed the announcement by Saudi Arabia and other Arab states, in October of 1973, that they were cutting back on their oil production and embargoing shipments of oil to the United States and other supporters of Israel. This cutback did not result from any OPEC decision, either. Indeed, many OPEC states—including Iran, Indonesia, Venezuela, Ecuador, and Gabon—actually increased production (and even a few Arab states in OPEC, notably Iraq and Algeria, did not reduce their production). It was almost exclusively an initiative of Saudi Arabia, which was backed vocally, if not materially, by its Arab allies. Moreover, the Saudi decision to shut down 10 percent of the country's oil production was not based entirely on considerations of the plight of the Arabs. The Senate Subcommittee on Multinational Corporations ascertained from testimony of American engineers who were responsible for operating the Saudi fields in 1973 that a 40 percent cutback in the giant Ghawar field—the largest in the world—was required for the installation of water-injection equipment. If it had not made these cutbacks, the entire reservoir of oil would have been jeopardized. Jerome Levinson, the general counsel of the committee, writing under the name Peter Achnacarry, stated: ". . . the embargo saved Saudi Arabia and Aramco [the operating consortium] from the embarrassment of having to explain supply shortages resulting from technical problems." By cloaking the cutback in a political purpose, the Saudis were able to induce other Arab producers, both inside and outside of OPEC, to join them.

In the wild price spiral that followed the Saudi shutdown, the official OPEC price was completely disregarded by other members. Iran and Qatar held auctions to determine how high they could raise prices. At its subsequent meetings, OPEC could do no more than ratify the prices that had already been established by a panicked market.

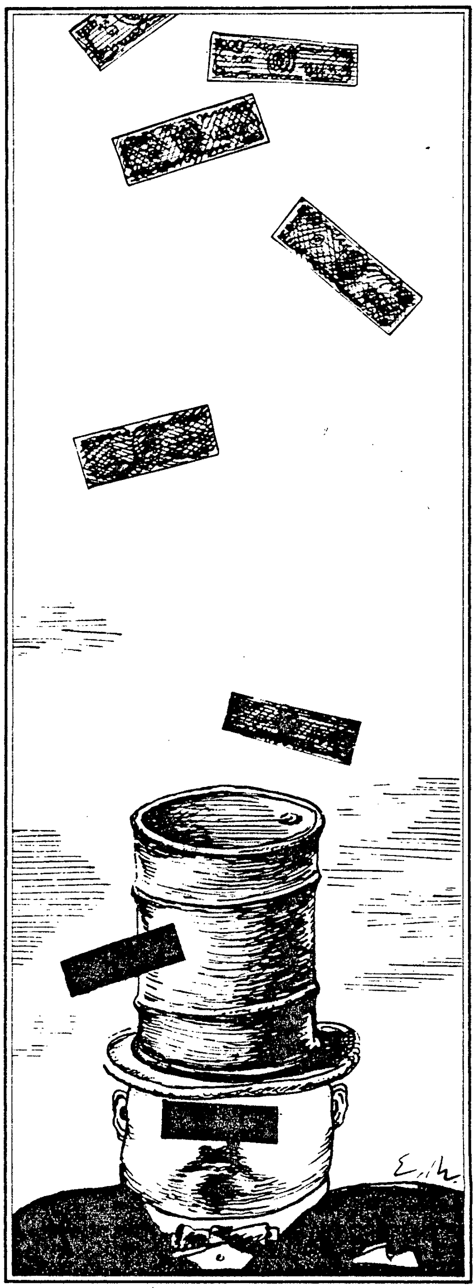
Conversely, when oil prices began to decline in 1975, because of the world recession, OPEC found itself powerless to stop its members from undercutting each other and competing for sales. Despite OPEC's price declarations, the real price of oil declined by more than 25 percent between 1975 and 1978. The decline was reversed, not by any actions of OPEC but by another series of events in the Persian Gulf: the revolt against the Shah in Iran; a brief rebellion in Saudi Arabia; Iraq's invasion of Iran. In a matter of months, some 5 or 6 million barrels a day of Persian Gulf oil vanished from the export market. In 1979, importers feverishly bid up the remaining supply for their strategic reserves until prices reached $35 a barrel.

Throughout this roller coaster of falling and soaring prices, OPEC demonstrated little ability to affect or even moderate the actions of its members. Price agreements were totally ignored, and the idea of regulating oil production was pre-emptively rejected. In a comprehensive study of OPEC prices, Walter J. Mead, an economist at the University of California, found that "price and output policies [of members] appear to be determined independently of OPEC policy." He concluded that OPEC could not be considered a cartel in the light of this data, because "the essential ingredient to an effective cartel, coordinated control over output, is totally lacking." OPEC merely took credit for the results of current events.

Whereas OPEC may have proved to be no more than a paper cartel, one nation—Saudi Arabia—succeeded in altering the market by dramatically varying the output from its fields. After all, it was Saudi Arabia, not OPEC, that shut off oil during the Yom Kippur War. It was also Saudi Arabia that, without even consulting OPEC, arbitrarily reduced production in the midst of the Iranian revolt. And it was Saudi Arabia that later flooded the market for the stated purpose of forcing other OPEC members to conform to its pricing policies. Yet, even though Saudi Arabia was the real manager of the world oil supply, statesmen around the world preferred to blame an almost nonexistent organization—OPEC.

In July of 1979, President Jimmy Carter received a memorandum from his chief domestic adviser, Stuart Eizenstat, suggesting that public attention be focused on OPEC. Specifically, it counseled that "with strong steps we can mobilize the nation around a real crisis and with a clear enemy—OPEC." Whether Carter and his advisers were cynical in their search for a scapegoat or ill-informed about the determining role Saudi Arabia played in manipulating the supply of oil, they adopted the general strategy of blaming OPEC for the world's ills. Carter said, "I don't see how the rest of the world can sit back in a quiescent state and accept unrestrained and unwarranted increases in OPEC oil prices." Then, after castigating OPEC in a nationwide address, he read from his notebook a chilling assessment: "Our neck is stretched over the fence and OPEC has the knife." Carter gave this enemy a quality of omnipotence several months later, when he said that OPEC "has now become such an institutionalized structure that it would be very doubtful that anyone could break it down." OPEC was turned into an undefeatable foe.

OPEC made an especially convenient "clear enemy" precisely because it hardly existed. If a real country were chosen for this role, there would be real consequences. Consider, for example, what would have happened if Carter had substituted "Saudi Arabia" for "OPEC" in his denunciations. He would have to have depicted Saudi Arabia hold-



ing a knife to America's outstretched neck—an image hardly consistent with continued military and technical aid to that country. OPEC, on the other hand, with which the United States had neither trade nor foreign relations, provided an ideal diversion from reality. It also yielded a four-letter word for the press to use in headlines. Oil companies could put the blame for gas lines and soaring prices on OPEC, with which they had no commercial relations, without offending the countries on which they depended for supplies.

OPEC served an even more important purpose for the oil-exporting nations. It gave powerless nations, which had the means neither to operate their oil fields nor to defend themselves, a dazzling mask. Specifically, for Saudi Arabia, which produces almost half of OPEC's oil, it provided international camouflage for its oil policy. Just as the United States used the OAS as a mask for the embargo on goods shipped to Cuba in the 1960s, and the Soviet Union used the Warsaw Pact as a mask for intervention in Czechoslovakia in 1968, Saudi Arabia used OPEC to obscure its manipulation of the oil market. Such diversionary tactics were especially important to Saudi Arabia, since in 1973 its oil fields were almost entirely in the hands of American technicians and engineers, and its army, fewer than 3,000 men located at bases 1,000 miles away from the oil fields, was hardly in a position to defend the fields.

Finally, OPEC, with its 300-seat press auditorium and television studio, provided a theater in which member countries could play the roles they preferred—hawk, dove, or moderate—for public consumption without constraining their actions in the marketplace. Libya and Iran, for example, chose to play the role of price hawk in the 1982 season; in fact, both countries relentlessly cut prices and gave secret discounts. Saudi Arabia, on the other hand, chose to play the role of a moderate and friend of the West. In 1977, for example, it approved an average production increase of 2 million barrels a day over a six-month period. The promised oil, however, never materialized; Saudi Arabia perfunctorily explained that a seven-week storm in the Persian Gulf had prevented oil loadings. The U.S. Weather Bureau was unable, with all its electronic wizardry, to find any meteorological evidence of this putative act of God.

UNTIL 1982, OPEC SET PRICES FOR OIL VERY MUCH the way the king in *Le Petit Prince*, to impress his subjects, commanded the sun to set each day—after consulting a timetable. As long as the wars and chaos in the Middle East drove prices up, OPEC could continue with due pomp to make its announcements of price rises. This game could not be played, however, in the face of falling prices. By March of 1982, world demand for oil had so diminished that refineries were closing throughout Europe and stocks were being dumped onto the market at an alarming rate.

The competition within OPEC for shares of the oil market has been greatly exacerbated in recent years by the loss of nearly one third of the world market to interlopers such as Mexico, Great Britain, Norway, Malaysia, Russia, and Egypt. In 1973, when OPEC began its thundering rise to eminence, its members produced almost all the exportable oil in the world. In 1983, according to a recent Exxon projection, non-OPEC nations (not including the United States) will produce about 13 million barrels a day, equivalent to nearly two thirds of OPEC's total. Mexico, which will produce 2.9 million barrels a day, will export more oil than any OPEC country except Saudi Arabia; and Great Britain and Norway will produce 2.7 million barrels a day from North Sea fields. As the available portion of the market shrinks, OPEC nations, many of whom are desperate for revenues, can compete only by lowering prices. As prices last year continued to slip day by day, it became clear to all concerned that OPEC could no longer even pretend to command prices to rise with any effect.

On March 6, Saudi Arabia called a strategy meeting in advance of the scheduled Vienna meeting in the tiny city of Doha, on the Persian Gulf. It was attended by only nine OPEC members, who confronted the vexing problem of how OPEC could lower its official price to a competitive level without undermining its image of exerting control over the market. Saudi Arabia proposed shrouding the necessary price reduction in a semantic fog in which the "official OPEC price" would remain at $34 a barrel but the premiums charged for "differentials" in quality and transportation would be "adjusted." This would effectively reduce the price. The plan was ultimately rejected, because, as *Petroleum Intelligence Weekly*, a trade paper, observed, "The 'differential umbrella' is not large enough . . . to mask the market's perception of the price reductions required." The only answer, it was decided in Doha, was for Saudi Arabia to cut its production substantially.

Two weeks later, at the regular OPEC ministerial conference in Vienna, Sheikh Yamani told a press conference that the OPEC countries had decided to cut their oil production from 20 million to 17.5 million barrels a day. He further explained that they would allocate production quotas among themselves. The idea of rationing production was first broached in 1965, when the Seven Sisters still controlled the oil fields. The plan, called "the transitional production program," was rejected by both Saudi Arabia and Libya, and abandoned by an OPEC resolution in June of 1966—the only resolution OPEC ever passed on the subject of production cutbacks. In 1978, Venezuela secretly suggested to Saudi Arabia a program for production cutbacks, but the plan was never agreed upon by all OPEC members. Even after the March meeting, Yamani explained, "Saudi Arabia, as usual, disassociates itself from any production program. So, on an official level, we are not part of the decision."

Nevertheless, the Vienna announcement was hailed as confirmation that OPEC was a true cartel—a cartel capable of cutting back production to maintain prices in times of weak demand. In fact, however, no such OPEC decision was ever made at Vienna. To begin with, Iran had never agreed to the plan; it remained merely a pronouncement by Saudi Arabia. Moreover, the "allocations" assigned to the twelve other members were nothing more than the projections each had made of its planned production. At best, the announcement served to camouflage the reality that the cut came almost entirely from Saudi Arabia—not from a united OPEC. In the next four months, Saudi Arabia shut down about one third of its oil fields, and production dropped from some 7.5 million to barely 5 million barrels a day—a feat that cost Saudi Arabia up to $85 million a day in lost revenues. During this same period, most of the twelve other producers in OPEC, including Iran, Nigeria, Algeria, Libya, Venezuela, and Indonesia, actually disregarded the so-called allocations, and increased production. What was involved was not "cheating"—the allocations were never agreed upon—but the exposure of a thin disguise. For behind the announcement of OPEC joint action was a solitary actor, Saudi Arabia, which was attempting to hold up world prices. Unlike a real cartel, OPEC cannot promulgate actual production cuts among its members because of a simple reality: most OPEC members desperately need the money from oil to remain solvent.

DESPITE THE MYTH THAT OPEC STATES DO NOT need the oil revenues they receive, a secret 1982 CIA analysis showed that they would have a minimum balance-of-trade deficit of $17 billion last year and $25 billion this year. When the economic situation of the individual members is considered, it emerges that only a few have any real room to reduce production without causing financial calamity for themselves.

The members of OPEC fall into two distinct groups. The first is the nine most populous countries, who desperately need every dollar of oil income they can get. For example, Venezuela requires all the revenue from its present production of 2.3 million barrels a day just to pay the multibillion-dollar interest on its foreign debt. Ecuador, which is in even worse financial straits, at full capacity cannot pay its debt charges this year and has been forced into virtual bankruptcy. Nigeria, which imports more than $1 billion worth of goods each month, cannot further reduce oil production without depriving its population of food and other necessities. Gabon, the other Black African member of OPEC, is in a similar financial bind. Algeria, which has a $17.5 billion foreign debt, and Indonesia, which has a $26 billion foreign debt, are almost entirely dependent on oil revenues to avoid defaults. Libya, once a cash-rich nation, recently announced that it will have to continue to produce at least twice its "quota" in order to avoid bankruptcy. Finally, Iran and Iraq, locked in an expensive war, need their oil revenues to pay for arms and ammunition.

In the second group are the three small sheikhdoms on the Persian Gulf—Qatar, the United Arab Emirates, and Kuwait—and Saudi Arabia, which are much less populous and financially stronger. Qatar, however, is at present producing only 400,000 barrels a day, and has very little room to cut back without abandoning a multibillion-dollar project to build a port. The United Arab Emirates now spends almost its entire revenue on social programs and military forces, both designed to quell complaints in the poorer emirates, and it could cut back on oil production only at the risk of inciting unrest. Kuwait, the richest of the sheikhdoms, can afford to reduce oil production to assist OPEC, but it is now producing less than a million barrels a day, and requires the gas from this production to maintain an air-conditioned society and operate its desalinization machinery.

When the mask of OPEC unity is stripped away, Saudi Arabia is left as the only state capable of substantially manipulating oil prices, with perhaps a modicum of assistance from Kuwait and the other Gulf sheikhdoms. But how long can even Saudi Arabia afford to keep up oil prices? To be sure, Saudi Arabia's revenues from oil have been immense. But so have its expenditures. By 1980, it was conservatively estimated that Saudi Arabia's projected five-year plan for development would cost $380 billion—or $50,000 per person. For the coming fiscal year, Saudi expenditures are estimated to be about $93 billion, not including the billions of dollars it lends to Iraq for its war. A secret CIA report estimates that 1982 Saudi oil revenues totaled only $68.6 billion—a decrease of $44 billion from 1981. This sum, together with about $12 billion the country earns from interest on its reserves, and $3 billion from internal revenues, would leave Saudi Arabia with a shortfall in its budget of $9.4 billion. And the deficit would grow by about $12.5 billion for each million barrels a day by which it reduced its production. In 1981, Saudi Arabia had a balance-of-payments surplus of $43 billion; this year, if oil prices remain weak, it may have a deficit as high as $20 billion—the first substantial deficit in more than a decade. At this rate, not even Saudi Arabia can afford to cut back drastically for a prolonged period without depleting its reserves. For example, Saudi reserves, estimated to be $150 billion, would last only about three years if the country cut oil production back by 3 million barrels a day.

Last fall, Saudi Arabia was having increasing difficulty meeting its bills on time, according to the cable traffic between the U.S. Embassy in Riyadh and the State Department in Washington. While Saudi Arabia could possibly reduce its expenditures for social and military programs the better to afford a huge cut in its oil production, such a course would involve political consequences. For example, last fall, when the interior minister ordered a reduction in the government subsidy given Saudis for electricity, King Fahd, according to an American Embassy report, abruptly countermanded the order, apparently because of his concern that it might lead to political unrest. In October, U.S.

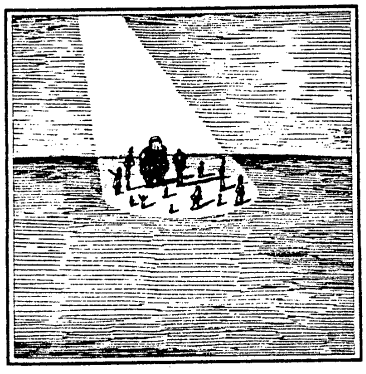
Embassy cables reported that Saudi pressure was being applied to commercial banks to prevent them from transferring private deposits to international accounts, which might precipitate a flight of capital.

When Sheikh Yamani demanded last December that OPEC nations defend the "OPEC" price of $34 a barrel, he was in reality insisting that these nations defend the Saudi price, under the implicit threat of a price war. For Saudi Arabia had neither the resources nor the will to continue its single-handed manipulation of oil prices. The insoluble problem is that the other producers—with the possible exception of Kuwait—cannot afford to shut down their oil production. OPEC, the cartel that never really was, can offer little relief.

At the Vienna conference, Sheikh Yamani warned that the collapse of OPEC would cause a world financial crisis that would drive many debtor nations, such as Mexico, into bankruptcy. This new line, which echoed through both the financial press and government deliberations, argued against any effective actions of the industrialized world—such as releasing government-controlled oil reserves or imposing new taxes on oil consumption—that would undermine the OPEC price. In early January, however, a secret CIA report circulated in the highest councils of the government arrived at very different conclusions. The report, called "Global Implications of Declining Oil Prices," says that whereas the balance of payments of oil-exporting nations, such as Mexico, Nigeria, and the Soviet Union, would be severely damaged by a sharp decline in oil prices, oil-consuming nations, such as Brazil, South Korea, and India, would correspondingly benefit from the price decrease. This might cause temporary problems for the world banking system, but the losses and gains would eventually cancel out. The CIA study estimates that Saudi Arabia has lost nearly $1 billion a week since last March because of cutbacks made in support of the price of $34 a barrel. If, however, Saudi Arabia lets the price fall, the CIA's econometric model suggests that the world economy would greatly benefit. A drop in oil prices to $20 a barrel, according to the report, would increase the GNPs of twenty-six industrial nations, including the United States, Japan, and most countries in Europe, by an average of 2 percent—an increment sufficient to pull most Western nations out of the current recession. A special section of the report, called "The Soviet Connection," estimates that the same drop in price would mean a loss of $8 billion in hard currency for Russia, because of a drop in both oil sales and sales of arms to Libya, Iraq, and Iran.

For nearly a decade, the OPEC mask has permitted Saudi Arabia to set prices for the world without having to take direct responsibility for its actions. As prices continue to fall, however, the façade no longer hides the bitter rivalries and squabbles among members. Simply because OPEC's members have a common interest in the oil market does not guarantee that they can resolve their rivalry. The paradoxical question "What are we fighting about, since we want the same thing?" applies to their dilemma. The answer is that they are fighting precisely because each wants a larger share of the world oil market. If, however, any one member succeeds in enlarging its share, it will be at the expense of another member. The OPEC members are, and will always be, competitors—not allies. While they may try to hide their fighting from outsiders by means of unenforceable paper agreements, it will persist until it is resolved by a price war.

Oil prices have risen twentyfold over the past decade. Part of this dramatic increase has been the result of the free market's attempt to reconcile dwindling production in America and elsewhere with expanding demand. Another part was the result of the fears generated by wars and upheavals in the Persian Gulf, which in turn led to frantic efforts to hoard oil in anticipation of an uncertain future. And part was the result of the manipulations of a few countries—notably Saudi Arabia and Libya—that cut back production at moments of world crisis. OPEC was undeniably important during this period, but not as a production-fixing cartel. It was a convenient diversion that distracted public attention from the real causes of the oil crisis. □



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